DG 01-125

NORTHERN UTILITIES, INC.

Guaranteed Price Service Program Proposal

Order Approving Fixed Price Option Program

O R D E R N O. 23,740

July 12, 2001

APPEARANCES: Rubin & Rudman, L.L.P., by Frank Pozniak, Esq., on behalf of Northern Utilities, Inc.; Office of Consumer Advocate by Kenneth E. Traum on behalf of residential ratepayers; and Donald M. Kreis, Esq. for the Staff of the New Hampshire Public Utilities Commission.

I. PROCEDURAL HISTORY

On June 8, 2001, Northern Utilities, Inc. (Northern) filed with the New Hampshire Public Utilities Commission (Commission) its Guaranteed Price Service (GPS) Program Proposal. The filing was made in response to Order No. 23,581 (October 31, 2000), in Docket DG 00-194, Northern's Winter 2000/2001 Cost of Gas proceeding, which directed Northern to explore the use of financial instruments for hedging and/or implementation of a Fixed Price Option (FPO) program and to discuss those policies with the Office of the Consumer Advocate (OCA) and Commission Staff (Staff) no later than February 28, 2001. On February 16, 2001, Northern met with the OCA and Staff to discuss the FPO and hedging issues. The June 8, 2001 filing was accompanied by the prefiled direct testimony and supporting schedules of Francisco C. DaFonte, Director, Gas Control.

By an Order of Notice issued June 13, 2001, the Commission scheduled a hearing for July 6, 2001 and set deadlines for intervention requests and objections thereto.

On June 18, 2001, Staff propounded data requests to Northern. On June 20, 2001, Northern responded to Staff's data requests. Also on June 20, 2001, Northern and Staff discussed the data responses in a telephone conference. The OCA was aware of the meeting but did not participate in the conference.

On June 27, 2001, the OCA filed a Notice of Intent to Participate in this docket on behalf of residential utility ratepayers pursuant to the powers and duties granted to the OCA under RSA 363:28. There were no other intervenors in this proceeding.

On July 2, 2001, Staff filed with the Commission a Settlement Agreement dated June 29, 2001 entered into among Northern, OCA and Staff relating to Northern's petition. A duly noticed hearing on the merits was held at the Commission on July 6, 2001.

II. NORTHERN'S GUARANTEED PRICE SERVICE PROGRAM PROPOSAL

Northern proposed to implement a Guaranteed Price

Service optional tariff for the 2001/2002 winter period. At the hearing, Northern's witnesses testified that Northern believes that now is the right time to offer the FPO program due to the recent volatility in natural gas commodity prices and an expected customer readiness or demand for such a program. Under the proposal, Northern’s customers would have the option of purchasing their gas service under the traditional Cost of Gas (COG) tariff, which is subject to monthly variations, or under the newly established GPS tariff, which would ensure a set price per therm sold during the winter period to customers who desire price certainty.

Northern stated in its filing that it would supply GPS customers through pipeline, storage and peaking resources in its existing portfolio. However, Northern would hedge the cost of some of these supplies to match the fixed-cost requirements as closely as possible. In particular, Northern would hedge a portion of pipeline supplies over the off-peak period. Additionally, volumes injected into storage during the injection season would also provide a hedged supply for GPS customers. Based on this approach, approximately 99 percent of the GPS requirements under normal weather conditions would be price-hedged.

Northern proposed to calculate three GPS prices applicable to residential, commercial and industrial (C&I) low winter use, and C&I high winter use customers. Northern's COG price to these three groups would reflect differing allocations of pipeline, storage and peaking supplies and associated costs resulting from Northern's most recent rate redesign case. The same allocations used to develop COG prices would be used to develop GPS prices.

Northern proposed to notify customers of the program through informational inserts in the August 2001 billings. The program would be open to all customers and enrollment would be on a first-come first-served basis through a mail-in response, beginning September 15 and remaining open for 30 days or until fully subscribed. In order to provide all customer classes with a reasonable opportunity to participate in the program, the overall program cap would be divided proportionately between residential and non-residential customers. Any unused volumes in one pool could be allotted to the other pool, if it were oversubscribed. The proposed tariff would require customers to remain on GPS service for the entire six-month winter period. The GPS rate would be based on the cost of hedged supplies, estimated transportation costs and program costs.

III. SETTLEMENT AGREEMENT

After several discussions, Northern, the OCA (the Parties) and Staff entered into a Settlement Agreement (Settlement). The Settlement is intended to resolve all issues related to Northern's petition. The terms of the Settlement are summarized below:

1. The Parties and Staff agree Northern will rename its Guaranteed Price Service Program as the Fixed Price Option program (or FPO program).

2. The Parties and Staff agree the goal of the FPO program is to guarantee a set rate for enrolled customers during the term of the program, November 2001 through April 2002, which may not necessarily result in the lowest prices.

3. The Parties and Staff agree the enrollment period for the program will be from September 15, 2001 through October 15, 2001.

4. The Parties and Staff agree enrollment will be capped at 50 percent of Northern's New Hampshire firm sales load on a first-come first-serve basis and that customers will be required to remain in the FPO program for the entire six-month period it is offered.

5. The Parties and Staff agree Northern will notify customers of the FPO program via bill inserts in August 2001, and via first class mail in September 2001.

6. The Parties and Staff agree the means of enrollment will be by customer submission of enrollment forms and will not be via verbal means.

7. The Parties and Staff agree the eligibility for the FPO program will be divided proportionally between residential and non-residential customer pools ensuring that each group has a reasonable opportunity to participate. Any unsubscribed volumes in one pool may be

utilized to meet an over-subscription in the other pool.

8. The Parties and Staff agree administrative costs associated with the FPO program will be allocated 50 percent to Cost of Gas customers and 50 percent to FPO customers resulting in an uniform rate impact to all customers for these administrative costs.[1]

9. The Parties and Staff agree that the FPO rate will include a credit for the FPO service's allocated share of actual known capacity release, off-system sales and interruptible sales credits (i.e., margins from May 2001 through July 2001). Estimated future margins will not be included in the FPO rate calculation, but rather will be credited to COG service only.

10. The Parties and Staff agree that the FPO will include a premium to protect the COG customers from the potential of under-recovery of costs from FPO participants. The premium will be calculated as follows:

    a) If the calculated FPO is less than or equal to 95% of the projected COG rate for the winter period, the FPO rate will be calculated as the FPO multiplied by 105%. In no event will the FPO be less than 95% of the projected COG rate for the winter period.

    b) If the calculated FPO rate is greater than 95% of the projected COG rate for the winter period but less than

---

[1] At hearing, Northern's witnesses confirmed that administrative costs will actually be allocated such that each customer pays the same share of those costs whether they are taking service under the FPO or COG tariff. Thus, the administrative costs would only be allocated equally between the two programs if the FPO is fully subscribed. Since neither Staff nor OCA objected to this clarification, we will assume it is consistent with the Settlement Agreement.

100% of the projected COG rate for the winter period, then the FPO rate will be calculated as the FPO rate multiplied by 105%.

c) If the calculated FPO rate is greater than or equal to 100% of the projected COG rate for the winter period but less than 105% of the projected COG rate for the winter period, then the FPO rate will be calculated as the COG rate multiplied by 105%.

d) If the calculated FPO rate is greater than or equal to 105% of the projected COG rate for the winter period, then the FPO rate will be established as originally calculated.

11. The Parties and Staff agree Northern will utilize physical and financial hedges to stabilize a portion of its gas supply costs commensurate with the level of the FPO program that is offered. These hedges may include: purchasing supplies now for later use, entering into one or more fixed-price contracts with suppliers, or trading financial instruments or contracts on the NYMEX. The actual transactions will be executed by Northern’s parent company, NiSource, Inc.

12. The Parties and Staff agree Northern's proposal will be capped at 50 percent, rather than 60 percent as proposed. Northern will hedge 99 percent of its supplies for these participating customers under normal weather conditions in order to provide price stability for its customers.

13. The Parties and Staff agree Northern will submit to the Commission, by November 15, 2001, a report identifying the number of customers participating in the FPO program as well as the volume of gas subject to the enrollment. The volume reported will be broken down by residential and non-residential classes.

14. The Parties and Staff agree Northern will submit to the Commission, by March 15, 2002, a report of the preliminary evaluation of the FPO program.

IV. COMMISSION ANALYSIS

After careful review of the record in this docket, we find that Northern's Fixed Price Option Program, as modified by the terms of the Settlement Agreement, is consistent with the public good.

New Hampshire’s current COG service is designed to adjust the COG rate on a monthly basis, to reflect market prices more accurately than a less regularly adjusted rate would, and has resulted in frequent COG rate changes. The FPO offers an alternative to customers who do not want to be subject to the volatility of market prices and fluctuating rates over the winter period and is consistent with prior Commission orders that directed gas companies in New Hampshire to mitigate natural gas price volatility at a minimal cost. Northern’s FPO program is similar to fixed price plans offered in the competitive market by oil and propane dealers, as well as natural gas marketers and the other gas utilities operating in New Hampshire, that ensure a set price for the winter period to customers who desire price certainty.

Enrollment in the FPO will commence when Northern files for its winter COG rate, enabling customers to better evaluate the risks associated with their purchasing options.

The proposed premiums applied to the FPO rate should result in FPO and COG rates that are closely linked and, therefore, customer participation will be determined by risk aversion rather than price differentials. The availability of two pricing options will allow firm sales COG customers to decide the level of price risk they wish to tolerate while providing better price signals to the marketplace.

Variances in the revenues and costs associated with the FPO are likely, as usage and supply mix are based on normalized weather. Any resulting over or under-collection should not be significant and should be offset by margins that will be credited to the firm sales COG customers and by the premium established in Section IV, 10 of the Settlement. Northern's witnesses testified at the hearing that the premium could be approximately 3.75 cents per therm. This is the additional cost per therm a customer would pay to obtain a firm price for the winter period and also to protect COG customers from a potential under-recovery of gas costs from FPO customers.

We agree that as an initial offering the program should be limited and we believe that fifty percent (50%) of the weather normalized winter period therm sales is a reasonable amount to be offered for the coming winter based on the participation levels experienced for the FPO programs offered by KeySpan Energy Delivery New England (KeySpan) and New Hampshire Gas Corporation (NHGC). Both KeySpan and NHGC had capped participation at 20% and their programs were significantly oversubscribed for the 2000/2001 winter period. If the FPO is undersubscribed, the supplies purchased for the FPO will be deemed to be additional volumes hedged for the firm sales COG customers.

We also approve of Northern’s hedging policy, whereby minimum amounts are to be hedged by specific dates or when certain target prices are met. This sort of “dollar-cost averaging” or “value-cost averaging” strategy, in which a fixed dollar amount is invested on a regular basis or when a target price is realized, has been used to lower the average cost when prices fluctuate. Given the volatility of natural gas prices, we believe such a strategy reduces the speculative nature of gas purchasing as has been practiced in the past and should ultimately result in lower gas cost rates.

In a market where prices have traditionally risen during the winter, both FPO and COG customers should likely benefit as FPO participants pay a price based on natural gas supplies locked in during the summer and the COG customers retain margins which would normally be spread over all firm sales COG customers.

That said, the FPO should be treated as a pilot program for the 2001/2002 winter period. The program should be closely monitored and the results reviewed and evaluated to serve as a basis for continuing and improving the plan going forward. We believe that the terms of the Settlement addressing monitoring and evaluation of the FPO program will provide Northern, the OCA and Staff sufficient information to discuss whether the program should be offered in subsequent years and whether any program modifications are necessary. We also note Northern's agreement to submit for Staff review the FPO promotional materials it intends to send customers with their August bills and the September direct mailing.

Based upon the foregoing, it is hereby

ORDERED, that the proposed Fixed Price Option Program, as modified by the terms of the Settlement Agreement, is hereby APPROVED; and it is

FURTHER ORDERED, that Northern will hedge a minimum of 50 percent of its 2001/2002 winter gas supply portfolio in support of its FPO program through: the use of financial instruments to hedge 50 percent of its upstream pipeline supplies; fixing prices for Liquid Natural Gas and Liquid Propane contracts with its suppliers; and the use of physical hedges afforded it by underground storage.

By order of the Public Utilities Commission of New Hampshire this twelfth day of July, 2001.

Douglas L. Patch Chairman	Susan S. Geiger Commissioner	Nancy Brockway Commissioner

Attested by:

Claire D. DiCicco
Assistant Secretary